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CHIEF OF STAFF

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*Shealy Boland Reibold
Counsel for ORS*

October 29, 2007

VIA E-FILING AND HAND-DELIVERY

The Honorable Charles L.A. Terreni
Chief Clerk/Administrator
Public Service Commission of South Carolina
101 Executive Center Drive
Columbia, South Carolina 29210

RE: Application of Harbor Island Utilities, Inc. for approval of a new schedule of rates and charges for water and sewer service provided to residential and commercial customers in Harbor Island, Beaufort County, South Carolina
Docket No. 2007-243-WS

Dear Mr. Terreni:

Enclosed for filing please find the original and five (5) copies of the Explanatory Brief and Joint Motion for Settlement Hearing and Adoption of Settlement Agreement in the above-referenced matter. Attached thereto you will find the Parties' Settlement Agreement of today's date and supporting documentation submitted in accordance with the Commission's June 13, 2006 Settlement Policies and Procedures.

I would appreciate your acknowledging receipt of these documents by date-stamping the extra copy that is enclosed and returning it to me via our courier delivering the same. By copy of this letter, I am providing a copy of same to counsel for Harbor Island. If you have any questions or if you need any additional information, please do not hesitate to contact us.

Sincerely,

Shealy Boland Reibold
Shealy Boland Reibold

Enclosures

cc: J. Thomas Mikell

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2007-243-WS

IN RE:

Application of Harbor Island Utilities, Inc.
for Approval of a New Schedule of Rates
and Charges for Water and Sewer Service
Provided to Residential and Commercial
Customers in Harbor Island, Beaufort
County, South Carolina

**EXPLANATORY BRIEF AND JOINT
MOTION FOR SETTLEMENT
HEARING AND ADOPTION OF
SETTLEMENT AGREEMENT**

The South Carolina Office of Regulatory Staff (“ORS”) and Harbor Island Utilities, Inc. (“Harbor Island” or “the Company”) (collectively “the Parties”) pursuant to 26 S.C. Code Ann. Regs. 103-829, the Settlement Policies and Procedures of the Public Service Commission of South Carolina (“the Commission”), revised June 13, 2006, and other applicable statutes, rules and regulations, hereby file this Explanatory Brief and Joint Motion to establish a settlement hearing in the above-captioned proceeding and for approval of the settlement agreement filed herewith. In support of this Joint Motion, the Parties state as follows:

1. On June 25, 2007, Harbor Island filed an Application seeking an adjustment of its rates and charges for the provision of its water and sewer services. Harbor Island filed a Revised Application on August 24, 2007. By its Revised Application, the Company sought an increase in annual water revenues of \$88,486. Pursuant to S.C. Code Ann. Section 58-4-10(B), ORS is a party of record in this proceeding. Further, ORS and Harbor Island are the only parties of record in the above-captioned docket.

2. Following ORS' financial and business compliance audit of Harbor Island and extensive discussions concerning the issues in the above-captioned proceeding, Harbor Island has determined that its interests, and ORS has determined that the public interest, would best be served by stipulating to a comprehensive settlement of all issues pending in the above-captioned proceeding. The agreement detailing the terms and conditions of the settlement is provided herewith as Attachment "A." The basis and rationale for the settlement is set forth in the proposed settlement testimonies of Christina L. Seale, Robert G. Gross, and Willie J. Morgan, copies of which are attached as Exhibits "A," "B," and "C" to Attachment "A."

3. Currently, the hearing in this matter is scheduled for November 7, 2007. In order to present the merits of the settlement agreement to the Commission, the Parties jointly move that the Commission commence a settlement hearing on November 7, 2007.

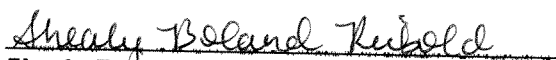
4. The Parties submit that the settlement agreement produces rates that are just and reasonable and move its approval as being in the public interest.

WHEREFORE, having fully set forth their Explanatory Brief and Joint Motion, the Parties request that the Commission 1) permit the Parties to present the merits of the settlement agreement on November 7, 2007, and 2) issue an order approving the Parties' settlement agreement as just, fair and reasonable.

[SIGNATURES ON FOLLOWING PAGE}

WE SO MOVE:

Representing the Office of Regulatory Staff



Shealy Boland Reibold, Esquire

South Carolina Office of Regulatory Staff

1441 Main Street, Suite 300

Columbia, SC 29201

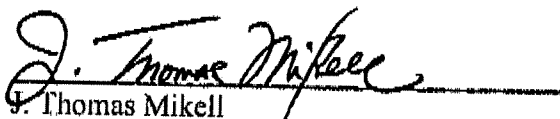
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WE SO MOVE:

Representing Harbor Island Utilities, Inc.



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Law Office of J. Thomas Mikell, PC

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BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2007-243-WS
October 29, 2007

Application of Harbor Island Utilities, Incorporated)
For Approval of a New Schedule of Rates and) **SETTLEMENT AGREEMENT**
Charges for Water and Sewer Service Provided to)
Residential and Commercial Customers in Harbor)
Island, Beaufort County, South Carolina)

This Settlement Agreement is made by and between the South Carolina Office of Regulatory Staff (“ORS”) and Harbor Island Utilities, Incorporated. (“Harbor Island,” “the Company,” or “the Applicant”) (together referred to as the “Parties” or sometimes individually as “Party”).

WHEREAS, the Company has prepared and filed an Application for approval of a new schedule of rates and charges for water and sewer service provided to residential and commercial customers in Harbor Island, Beaufort County, South Carolina filed on August 24, 2007 (“Revised Application”);

WHEREAS, the above-captioned proceeding has been established by the South Carolina Public Service Commission (“Commission”) pursuant to the procedure established in S.C. Code Ann. § 58-5-240 (Supp. 2006);

WHEREAS, ORS has examined the books and records of the Company relative to the matters raised in the Revised Application and, in connection therewith, has requested of and received from the Company additional documentation;

WHEREAS, the Parties have varying legal positions regarding the issues in this case;

WHEREAS, the Parties have engaged in discussions to determine if a settlement of the issues would be in their best interests and in the case of ORS, in the public interest;

WHEREAS, following those discussions the Company has determined that its interests and ORS has determined that the public interest would be best served by stipulating to a comprehensive settlement of all issues pending in the above-captioned case under the terms and conditions set forth herein;

NOW, THEREFORE, the Parties hereby stipulate and agree to the following terms, which, if adopted by the Commission in its Order on the merits of this proceeding, will result in rates and terms and conditions of water and sewer service which are adequate, just, reasonable, nondiscriminatory, and supported by the evidence of record of this proceeding, and which will allow the Company the opportunity to obtain a reasonable operating margin.

1. The Parties stipulate and agree that the exhibits prepared by ORS and attached to the settlement testimony of Christina L. Seale (filed as Exhibit A) fairly and reasonably set forth the Company's operating expenses, pro forma adjustments, depreciation rates, revenue requirement, and operating margin.

2. The Parties stipulate and agree to include in the hearing record of this case the settlement testimony of Robert G. Gross (filed as Exhibit B), and the settlement testimony of Willie J. Morgan, including all exhibits attached to said pre-filed testimonies (filed as Exhibit C), without objection, change, or amendment.

3. The Parties stipulate and agree that the rate schedule, entitled Exhibit "WJM 5" to Settlement testimony of Willie J. Morgan, including the rates and charges and terms and conditions of service, are fair, just, and reasonable. The Parties further stipulate and agree that

the rates contained in said rate schedule are reasonably designed to allow the Company to provide service to its water and sewer customers at rates and terms and conditions of service that are fair, just and reasonable and provides the opportunity to recover the revenue required to earn a fair operating margin.

4. ORS is charged by law with the duty to represent the public interest of South Carolina pursuant to S.C. Code § 58-4-10(B) (added by Act 175). S.C. Code § 58-4-10(B)(1) through (3) reads in part as follows:

- ... 'public interest' means a balancing of the following:
- (1) concerns of the using and consuming public with respect to public utility services, regardless of the class of customer;
 - (2) economic development and job attraction and retention in South Carolina; and
 - (3) preservation of the financial integrity of the State's public utilities and continued investment in and maintenance of utility facilities so as to provide reliable and high quality utility services.

ORS believes the agreement reached between the Parties serves the public interest as defined above. The terms of this Settlement Agreement balance the concerns of the using public while preserving the financial integrity of the Company. ORS also believes the Settlement Agreement promotes economic development within the State of South Carolina. The Parties stipulate and agree to these findings.

5. In its Revised Application, the Company has requested an increase in total operating revenues of \$88,486. As a compromise to their respective positions, the Parties stipulate and agree to an increase in total operating revenues of \$71,284. This increase is supported by the adjustments reflected in Exhibit A.

6. The Company and ORS recognize the value of resolving this proceeding by settlement rather than by litigation (including but not limited to the reduction in rate case

expenses) and therefore stipulate and agree for purposes of settlement in this case that an operating margin of 10.60% is just and reasonable under the specific circumstances of this case in the context of a comprehensive settlement. In consideration of this Settlement Agreement, the Company agrees that no rate case expenses incurred after October 25, 2007 in relation to Docket No. 2007-243-WS shall be included for ratemaking purposes.

7. The Parties further stipulate and agree that this Settlement Agreement conclusively demonstrates the following: (i) the proposed accounting and pro forma adjustments and depreciation rates reflected in Exhibit A are fair and reasonable and should be adopted by the Commission for ratemaking and reporting purposes; (ii) the operating margin of 10.60% and an annual increase in total operating revenues of \$71,284, is fair, just, and reasonable when considered as a part of this stipulation and Settlement Agreement in its entirety; (iii) Harbor Island's services are adequate and being provided in accordance with the requirements set out in the Commission's rules and regulations pertaining to the provision of water and sewer services, and (iv) Harbor Island's rates as proposed in this Settlement Agreement are fairly designed to equitably and reasonably recover the revenue requirement and are just and reasonable and should be adopted by the Commission for service rendered by the Company on and after January 1, 2008.

8. The Company agrees to file with the Commission a performance bond for water service in the amount of \$215,000 and for sewer service in the amount of \$145,000 by January 1, 2008.

9. The Company agrees to provide advance notice to its customers prior to the implementation of these new rates.

10. The Company agrees to file a complete water audit report addressing water loss issues with the Commission pursuant to Commission Order 2002-866. A copy of the water audit report shall be submitted to the ORS.

11. The Company agrees to delete proposed tariff language regarding cost for delinquent accounts and keep a proposed \$10.00 charge for sending certified notice to delinquent customers.

12. The Company agrees to repair and/or replace fire hydrants on the island in response to concerns raised by ORS.

13. The Company agrees to continue to maintain its books and records in accordance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform Systems of Accounts.

14. The Parties agree that Harbor Island may pass through increased costs it incurs pursuant to its contracts with Beaufort-Jasper Water & Sewer Authority and Fripp Island Public Service District. However, these increases shall be subject to providing the Commission satisfactory proof of the basis for the adjustment and sufficient notice to customers as set out in Harbor Island's Revised Application.

15. The Parties agree to advocate that the Commission accept and approve this Settlement Agreement in its entirety as a fair, reasonable and full resolution of the above-captioned proceeding and to take no action inconsistent with its adoption by the Commission. The Parties further agree to cooperate in good faith with one another in recommending to the Commission that this Settlement Agreement be accepted and approved by the Commission. The Parties agree to use reasonable efforts to defend and support any Commission order issued approving this Settlement Agreement and the terms and conditions contained herein.

16. The Parties agree not to introduce or use this Settlement Agreement to constrain, inhibit, impair, or prejudice the other party in other proceedings. If the Commission should decline to approve the agreement in its entirety, then any Party desiring to do so may withdraw from the Settlement Agreement without penalty or obligation.

17. This Settlement Agreement shall be interpreted according to South Carolina law.

18. The above terms and conditions fully represent the agreement of the Parties hereto. Therefore, each Party acknowledges its consent and agreement to this Settlement Agreement by affixing its signature or by authorizing its counsel to affix his or her signature to this document where indicated below. Counsel's signature represents his or her representation that his or her client has authorized the execution of the agreement. Facsimile signatures and e-mail signatures shall be as effective as original signatures to bind any party. This document may be signed in counterparts, with the various signature pages combined with the body of the document constituting an original and provable copy of this Settlement Agreement. The Parties agree that in the event any Party should fail to indicate its consent to this Settlement Agreement and the terms contained herein, then this Settlement Agreement shall be null and void and will not be binding on any Party.

WE AGREE:

Representing the South Carolina Office of Regulatory Staff

Shealy Boland Reibold

Shealy Boland Reibold, Esquire

South Carolina Office of Regulatory Staff

1441 Main Street, Suite 300

Columbia, SC 29201

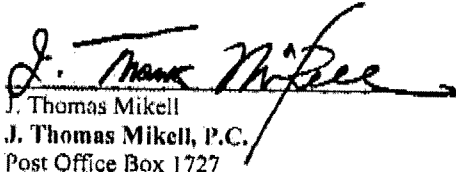
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WE AGREE:

Representing Harbor Island Utilities, Inc.

A handwritten signature in black ink, appearing to read "J. Thomas Mikell", is written over a horizontal line.

J. Thomas Mikell

J. Thomas Mikell, P.C.

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**THE OFFICE OF REGULATORY STAFF
SETTLEMENT TESTIMONY AND
EXHIBITS
OF
CHRISTINA L. SEALE**



EXHIBIT A

OCTOBER 29, 2007

DOCKET NO. 2007-243-W/S

**APPLICATION OF HARBOR ISLAND UTILITIES,
INCORPORATED FOR APPROVAL OF A NEW
SCHEDULE OF RATES AND CHARGES FOR
WATER AND SEWER SERVICE PROVIDED TO
RESIDENTIAL AND COMMERCIAL CUSTOMERS
IN HARBOR ISLAND, BEAUFORT COUNTY,
SOUTH CAROLINA**

SETTLEMENT TESTIMONY OF CHRISTINA L. SEALE**FOR****THE OFFICE OF REGULATORY STAFF****DOCKET NO. 2007-243-W/S****IN RE: HARBOR ISLAND UTILITIES, INC.**

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Christina L. Seale. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina, 29201. I am employed by the South Carolina Office of Regulatory Staff ("ORS") as an Auditor.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE.

A. I received a Bachelor of Science in Accounting with a minor in Computer Systems and Applications from Columbia College in 2000. From 2001 to 2004, I was employed by the South Carolina Office of the State Auditor. In that capacity, I performed agreed-upon procedures engagements and statewide single audits of various state agencies in South Carolina. In January 2005, I began my employment with ORS.

Q. WHAT IS THE PURPOSE OF YOUR SETTLEMENT TESTIMONY IN THIS DOCKET?

A. The purpose of my settlement testimony is to set forth the adjustments agreed upon in the Settlement Agreement ("the Settlement") between ORS and Harbor Island

1 Utilities, Inc. collectively referred to as "the Parties" in this docket. The adjustments
2 were based on ORS's examination of the Application of Harbor Island Utilities, Inc.
3 for approval of a new schedule of rates and charges for water and sewer service
4 provided to residential and commercial customers in Harbor Island, Beaufort County,
5 South Carolina filed on August 24, 2007 ("Revised Application").

6 **Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR**
7 **SETTLEMENT TESTIMONY.**

8 A. I have attached the following exhibits to my settlement testimony relating to the
9 Revised Application of Harbor Island Utilities, Inc. ("Harbor Island", "HIU" or the
10 "Applicant"):

- 11 ▪ Settlement Audit Exhibit CLS-1: Operating Experience and Operating
12 Margin
- 13 ▪ Settlement Audit Exhibit CLS-2: Explanation of Adjustments
- 14 ▪ Settlement Audit Exhibit CLS-3: Computation of Depreciation and
15 Amortization
- 16 ▪ Settlement Audit Exhibit CLS-4: Computation of Income Taxes

17 These exhibits were either prepared by me or were prepared under my direction and
18 supervision in compliance with recognized accounting and regulatory procedures
19 for water and wastewater utility rate cases. These exhibits show various aspects of
20 Harbor Island's operations, its financial position and the adjustments agreed upon
21 in the Settlement.

22 **Q. PLEASE DESCRIBE THE FORMAT OF SETTLEMENT AUDIT EXHIBIT**
23 **CLS-1 AND ELABORATE ON THE CALCULATIONS.**

1 A. Settlement Audit Exhibit CLS-1 shows Harbor Island's operating experience and
2 operating margin for water and sewer operations for the test year ended October 31,
3 2006. The exhibit's format is designed to reflect the Revised Application per books
4 and the proposed accounting and pro forma adjustments, per the Settlement,
5 necessary to normalize the results of Harbor Island's test year operations.

6 Column (1) shows the Revised Application per books computed by Harbor Island for
7 the test year ended October 31, 2006. The net operating loss of (\$45,796) was based
8 on total operating revenues of \$345,192 less total operating expenses of \$390,988.
9 The net operating loss less interest expense of \$31,789 resulted in a total loss for
10 return of (\$77,585). The operating margin of (22.48%) was computed by dividing
11 the total loss for return by the total operating revenues.

12 Column (2) shows the proposed accounting and pro forma adjustments per the
13 Settlement designed to normalize HIU's Revised Application per books. An
14 explanation of each adjustment is contained in Settlement Audit Exhibit CLS-2.

15 Column (3) shows the result of a normalized test year for Harbor Island by adding
16 columns (1) and (2). The net effect of the proposed accounting and pro forma
17 adjustments per the Settlement decreased total loss for return to (\$16,590) resulting
18 in an operating margin of (4.79%).

19 Column (4) shows the proposed increase per the Settlement and the calculation of
20 taxes and customer growth associated with the proposed increase. An explanation of
21 each adjustment is contained in Settlement Audit Exhibit CLS-2.

1 Column (5) shows the effect of the proposed increase per the Settlement by adding
2 columns (3) and (4). The net effect after the proposed increase resulted in total
3 income for return of \$44,247 and an operating margin of 10.60%.

4 **Q. PLEASE EXPLAIN THE ADJUSTMENTS IN SETTLEMENT AUDIT**
5 **EXHIBIT CLS-2.**

6 A. The following adjustments are the same as the adjustments listed in Settlement Audit
7 Exhibit CLS-2 under "Adj. #". For comparative purposes, the Settlement and Harbor
8 Island's Revised Application adjustments are both presented in Settlement Audit
9 Exhibit CLS-2.

10 Adjustment 1 and 2 – The ORS Water/Wastewater Department and HIU propose to
11 adjust water sales and sewer revenue to reflect actual customer units. The water sales
12 and sewer revenues were calculated using current customers as of October 31, 2006
13 and the Public Service Commission's ("PSC") approved rates. Details of these
14 adjustments are shown on Settlement Exhibit WJM-3 attached to the settlement
15 testimony of Willie Morgan, ORS Water/Wastewater Program Manager.

16 Adjustment 3 – The Parties propose to remove fees of (\$2,109) collected from the
17 customers for the Safe Drinking Water Fee ("SDWF") passed through to the South
18 Carolina Department of Health and Environmental Control ("DHEC").

19 Adjustment 4 and 5 – The Parties propose to remove water and sewer tap fees
20 included in revenues of (\$4,500) and (\$1,152), respectively. ORS and HIU also
21 propose to include these fees in Contributions in Aid of Construction ("CIAC").
22 These fees are shown on Settlement Audit Exhibit CLS-3 under additional CIAC
23 amortized per the Settlement.

1 Adjustment 6 – The Parties propose to remove remissions of (\$2,124) of SDWF to
2 DHEC from expenses.

3 Adjustment 7 – The Parties propose no adjustment to legal expenses associated with
4 the last rate case consistent with PSC Order No. 2002-866.

5 Adjustment 8 – ORS and HIU propose to annualize insurance expense for the test
6 year by removing (\$882) from the test year expenses.

7 Adjustment 9 – ORS and HIU propose to remove accounting expenditures of (\$540)
8 and reclassify appropriately as rate case expenses in Adjustment 23.

9 Adjustment 10 – The Parties propose to remove charitable donations paid during the
10 test year of (\$100).

11 Adjustment 11 – ORS and Harbor Island propose to remove administrative expenses
12 of (\$389) incurred outside the test year, but included in the cost of service.

13 Adjustment 12 – The Parties propose to remove the portion of tap fees paid to Fripp
14 Island Public Service District (“FIPSD”) of (\$4,344). This is considered a pass
15 through.

16 Adjustment 13 – ORS and HIU propose to remove water tap expenditures of
17 (\$1,152). Also, the Parties propose to capitalize and depreciate these expenditures as
18 shown on Settlement Audit Exhibit CLS-3 under additional fixed assets
19 capitalized/removed per the Settlement.

20 Adjustment 14 – The Parties propose to adjust expense for water used at the HIU
21 wastewater treatment plant to actual gallons used multiplied by the PSC’s approved
22 rate, for an adjustment of \$714.

1 Adjustment 15 – ORS and HIU propose to remove operating and maintenance
2 expenses of (\$15,618) incurred outside the test year, but included in the cost of
3 service.

4 Adjustment 16 – The Parties propose to remove expenses of (\$490) incorrectly billed
5 by HIU's administrative and operator services company, the Beaufort Group, LLC.

6 Adjustment 17 – ORS and HIU propose to adjust sludge disposal expense to reflect
7 the average of the years 2004, 2005 and 2006 of \$8,910. ORS witness, Mr. Morgan,
8 recommended this as a reasonable approach to normalize the sludge disposal expense
9 for rate making purposes. As a result, the Parties removed (\$2,334) from the Revised
10 Application per book amount of \$11,244.

11 Adjustment 18 – The Parties propose to remove from expense and capitalize plant-in-
12 service expenditures of (\$1,689) as recommended by ORS witness, Mr. Morgan.
13 The fixed assets are shown on Settlement Audit Exhibit CLS-3 under additional fixed
14 assets capitalized/removed per the Settlement.

15 Adjustment 19 – The Parties propose to remove expenses of (\$2,522) incorrectly
16 paid on behalf of another company.

17 Adjustment 20 – The Parties propose to correct the posting of the return of a fixed
18 asset made by HIU. Harbor Island purchased and booked the fixed asset for \$1,904.
19 When this fixed asset was returned, HIU incorrectly posted the return to an expense
20 account. The Parties' adjustment proposes to reverse this posting in the expense
21 account by \$1,904. The returned fixed asset is removed from plant-in-service as
22 shown on Settlement Audit Exhibit CLS-3 under additional fixed assets
23 capitalized/removed per the Settlement.

1 Adjustment 21 – ORS and Harbor Island propose to reduce purchased water expense
2 to exclude water losses in excess of 10%, as approved in the prior PSC Order No.
3 2002-866. HIU purchased 40,346,000 gallons of water, but only sold 33,484,000
4 gallons, which leaves them with an approximate 17% water loss of 6,862,000
5 gallons. PSC Order No. 2002-866 states:

6 An unaccounted for water rate of 10% is the lower end of the range for
7 unaccounted for water according to the American Water Works
8 Association Manual M32 (1989), of which [the PSC] took judicial
9 notice. Thus, non-allowance of unaccounted for water over 10% is
10 reasonable, and based on the AWWA standard.

11 Therefore, the Parties propose to adjust expenses to reflect only a 10% water loss,
12 which would calculate water purchased of 37,204,444 (33,484,000 water sold / 90%).
13 The total cost of water purchased with a 10% water loss is \$90,034 (37,204,444 x
14 \$.00242 (current cost of water charged by FIPSD and Beaufort-Jasper Water and
15 Sewer Authority)). The Parties' adjustment is (\$6,094) (\$90,034 – less Revised
16 Application per book amount of \$96,128).

17 Adjustment 22 – ORS and HIU propose to adjust depreciation and amortization on
18 all fixed assets and CIAC as of October 31, 2006 to reflect useful lives per the
19 Settlement. The CIAC and capital expenditures identified in the test year and noted
20 in adjustments 4, 5, 13 and 18 are also included in CIAC and plant-in-service. The
21 fixed asset noted in Adjustment 20 is removed from plant-in-service. ORS calculated
22 total depreciation expense of \$7,944 (Net depreciation expense of \$17,598 less total
23 CIAC of \$9,654) and reduced it by the Revised Application per book depreciation

1 expense of \$15,212 for a total adjustment of (\$7,268) as shown on Settlement Audit
2 Exhibit CLS-3.

3 Adjustment 23 – ORS and Harbor Island propose to include amortized rate case
4 expenses for the test year, which include accounting rate case expenses noted in
5 Adjustment 9. The Parties adjusted for actual current rate case expenses as of
6 October 25, 2007 of \$20,320 amortized over a two-year period less the Revised
7 Application per book amount of \$1,000 for an adjustment of \$9,160.

8 Adjustment 24 – The Parties propose to remove property taxes of (\$8,858) incurred
9 outside of the test year, but included in the cost of service.

10 Adjustment 25 – The Parties propose to adjust the gross receipts taxes associated
11 with the revenues after the proposed accounting and pro forma adjustments per the
12 Settlement. The adjustment was calculated by multiplying total gross revenues
13 after the proposed accounting and pro forma adjustments per the Settlement by
14 .0101856 (PSC and ORS factor of .0071856 and the South Carolina Department of
15 Revenue's factor of .003) less the Revised Application per book amount of \$2,842.

16 Adjustment 26 – ORS and HIU propose to remove interest paid of (\$18,426) during
17 the test year on non-utility debt.

18 Adjustment 27 – ORS and HIU propose to remove interest paid of (\$614) during the
19 test year for a non-recurring and paid loan.

20 Adjustment 28 – ORS and HIU propose to annualize interest paid during the test year
21 on the loan used to purchase fixed assets and make capital improvements, which
22 consisted of the effluent line replacement and the filter for the wastewater treatment
23 plant. These fixed assets are shown on Settlement Audit Exhibit CLS-3. Annualized

1 interest expense was calculated using the loan balance at the end of the test year of
2 \$155,398 and 8.75% (prime rate of 8.25% plus .5%) for a total of \$13,597. The
3 Parties' adjustment is \$848 (\$13,597 – less Revised Application per book amount of
4 12,749).

5 Adjustment 29 and 30 – The Parties propose a rate increase which will produce
6 additional revenues of \$71,284, consisting of water sales of \$23,708 and sewer
7 revenues of \$47,576. Details of these adjustments are shown on Settlement Exhibit
8 WJM-3 of Mr. Morgan's settlement testimony.

9 Adjustment 31 – ORS and HIU propose to adjust gross receipts taxes associated with
10 the proposed increase per the Settlement. The total gross revenues for the proposed
11 increase were multiplied by the gross receipts factor described in Adjustment 25.

12 Adjustment 32 – The Parties propose to adjust income taxes associated with the
13 proposed increase per the Settlement. See Settlement Audit Exhibit CLS-4.

14 Adjustment 33 – ORS and HIU propose to adjust customer growth associated with
15 the proposed increase per the Settlement. The adjustment was calculated by
16 multiplying net operating income after the proposed increase per the Settlement by
17 .013937. The factor of .013937 is calculated and shown on Settlement Exhibit
18 WJM-4 of the ORS Water/Wastewater Program Manager, Willie Morgan.

19 **Q. PLEASE DESCRIBE THE REMAINING SETTLEMENT AUDIT EXHIBITS.**

20 A. Settlement Audit Exhibit CLS-3 shows the computation of depreciation and
21 amortization. In addition to fixed assets per Harbor Island's depreciation schedule in
22 the Revised Application, capital expenditures, CIAC and adjustments identified in
23 the test year are included. Depreciation expense was annualized by using useful lives

1 per the Settlement. Settlement Audit Exhibit CLS-4 shows the computation of the
2 state and federal income taxes based on taxable income after the proposed increase
3 per the Settlement. A state tax rate of 5% and the federal tax rates of 15% and 25%
4 were used to calculate the income taxes.

5 **Q. WHAT IS THE RESULTING OPERATING MARGIN AFTER APPLYING**
6 **THE PROPOSED INCREASE PER THE SETTLEMENT?**

7 A. The revenue increase proposed in the Settlement will produce an operating margin
8 after interest expense of 10.6%, as shown on Settlement Audit Exhibit CLS-1.

9 **Q. DO YOU HAVE ANYTHING ELSE YOU WOULD LIKE TO ADD?**

10 A. Yes. ORS appreciates the timely support and cooperation by Harbor Island in
11 providing the information needed to examine its books and records.

12 **Q. DOES THIS CONCLUDE YOUR SETTLEMENT TESTIMONY?**

13 A. Yes.

Harbor Island Utilities, Inc.
Docket No. 2007-243-W/S
Operating Experience and Operating Margin
For the Test Year Ended October 31, 2006

	(1)	(2)	(3)	(4)	(5)
	Revised Application Per Books	Proposed Accounting & Pro forma Adjustments Per Settlement	After Proposed Accounting & Pro forma Adjustments Per Settlement	Proposed Increase Per Settlement	After Proposed Increase Per Settlement
<u>Operating Revenues</u>					
Water Sales	\$ 201,800	\$ 5,899 (A)	\$ 207,699	\$ 23,708 (L)	\$ 231,407
Sewer Revenue	134,998	2,722 (B)	137,720	47,576 (M)	185,296
Safe Water Drinking Fee	2,109	(2,109) (C)	0	0	0
Late Charges	633	0	633	0	633
Tap Fees	5,652	(5,652) (D)	0	0	0
<u>Total Operating Revenues</u>	\$ 345,192	\$ 860	\$ 346,052	\$ 71,284	\$ 417,336
<u>Operating Expenses</u>					
Administration	\$ 58,650	\$ (4,035) (E)	\$ 54,615	\$ 0	\$ 54,615
Water & Sewer Operation and Maintenance	204,741	(25,531) (F)	179,210	0	179,210
Water Purchase	96,128	(6,094) (G)	90,034	0	90,034
Depreciation and Amortization	15,212	(7,268) (H)	7,944	0	7,944
Rate Case	1,000	9,160 (I)	10,160	0	10,160
Taxes Other Than Income	15,257	(8,175) (J)	7,082	726 (N)	7,808
Income Taxes (State and Federal)	0	0	0	10,516 (O)	10,516
<u>Total Operating Expenses</u>	\$ 390,988	\$ (41,943)	\$ 349,045	\$ 11,242	\$ 360,287
<u>Net Operating Income (Loss)</u>	\$ (45,796)	\$ 42,803	\$ (2,993)	\$ 60,042	\$ 57,049
Add: Customer Growth	\$ 0	\$ 0	\$ 0	\$ 795 (P)	\$ 795
Less: Interest Expense	31,789	(18,192) (K)	13,597	0	13,597
<u>Total Income (Loss) for Return</u>	\$ (77,585)	\$ 60,995	\$ (16,590)	\$ 60,837	\$ 44,247
<u>Operating Margin</u>	-22.48%		-4.79%		10.60%

Harbor Island Utilities, Inc.
Docket No. 2007-243-W/S
Explanation of Adjustments
For the Test Year Ended October 31, 2006

Revenues and Expenses	Adj.#	Description	Settlement	Revised Application
<u>Proposed Accounting and Pro forma Adjustments Per Settlement</u>				
(A) Water Sales	1	To adjust water sales to reflect actual customer units.	5,899	5,687
(B) Sewer Revenue	2	To adjust sewer revenue to reflect actual customer units.	2,722	2,722
(C) Safe Water Drinking Fee	3	To remove fees collected from the customers for the SDWF passed through to DHEC.	(2,109)	(2,109)
(D) Tap Fees	4	To remove water tap fees from revenues and include in CIAC.	(4,500)	(4,500)
	5	To remove sewer tap fees from revenues and include in CIAC.	(1,152)	(1,152)
		Total Tap Fees	(5,652)	(5,652)
(E) Administration	6	To remove remissions of SDWF to DHEC from expenses.	(2,124)	(2,124)
	7	No adjustment is proposed to legal expenses associated with the last rate case consistent with the PSC Order No. 2002-866.	0	1,000
	8	To annualize insurance expense for the test year.	(882)	0
	9	To remove and reclassify accounting expenditures more appropriately classified as rate case expenses in Adjustment 23.	(540)	0
	10	To remove charitable donations paid during the test year.	(100)	0
	11	To remove administrative expenses incurred outside the test year, but included in the cost of service.	(389)	0
			(4,035)	(1,124)
(F) Water & Sewer Operation and Maintenance	12	To remove the portion of tap fees paid to FIPSD, as this is a pass through.	(4,344)	(4,344)
	13	To remove water tap expenditures from expenses and include in plant-in-service.	(1,152)	(1,152)
	14	To adjust for actual water used at the HIU wastewater treatment plant to the PSC approved rate.	714	(131)
	15	To remove operating and maintenance expenses incurred outside of the test year, but included in the cost of service.	(15,618)	0
	16	To remove expenses incorrectly billed by the Beaufort Group, LLC.	(490)	0
	17	To normalize sludge disposal expenses to reflect the average of a three-year period.	(2,334)	0
	18	To capitalize plant-in-service expenditures incorrectly expensed.	(1,689)	0

Harbor Island Utilities, Inc.
Docket No. 2007-243-W/S
Explanation of Adjustments
For the Test Year Ended October 31, 2006

Revenues and Expenses	Adj.#	Description	Settlement	Revised Application
(F) Water & Sewer Operation and Maintenance (Continued)	19	To remove expenses paid in the test year for another company.	(2,522)	0
	20	To correct the improper posting of the return of a fixed asset.	1,904	0
			<u>(25,531)</u>	<u>(5,627)</u>
(G) Water Purchase	21	To reduce purchased water expense to reflect water losses in excess of 10% as approved in prior PSC Order No. 2002-866.	<u>(6,094)</u>	<u>(6,094)</u>
(H) Depreciation and Amortization	22	To adjust depreciation and amortization on all fixed assets and CIAC to reflect useful lives agreed upon in the Settlement.	<u>(7,268)</u>	<u>0</u>
(I) Rate Case	23	To amortize total rate case expenses over a two-year period including expenses reclassified from Adjustment 9.	<u>9,160</u>	<u>5,000</u>
(J) Taxes Other Than Income	24	To remove property taxes incurred outside the test year, but included in the cost of service.	(8,858)	(8,858)
	25	To adjust the gross receipts taxes associated with the proposed accounting and pro forma adjustments per the Settlement.	683	0
		Total Taxes Other Than Income	<u>(8,175)</u>	<u>(8,858)</u>
(K) Interest Expense	26	To remove interest paid during the test year on non-utility debt.	(18,426)	(18,426)
	27	To remove interest paid during the test year for a non-recurring and paid loan.	(614)	0
	28	To annualize interest paid during the test year on the loan used to purchase fixed assets and make capital improvements.	848	623
			<u>(18,192)</u>	<u>(17,803)</u>
<u>Proposed Increase Per Settlement</u>				
(L) Water Sales	29	To adjust water sales to reflect the proposed increase per the Settlement.	<u>23,708</u>	<u>30,894</u>
(M) Sewer Revenue	30	To adjust sewer revenues to reflect the proposed increase per the Settlement.	<u>47,576</u>	<u>57,592</u>
(N) Taxes Other Than Income	31	To adjust gross receipts taxes associated with the proposed increase per the Settlement.	<u>726</u>	<u>0</u>
(O) Income Taxes (State and Federal)	32	To adjust income taxes associated with the proposed increase per the Settlement.	<u>10,516</u>	<u>0</u>
(P) Customer Growth	33	To adjust customer growth associated with the proposed increase per the Settlement.	<u>795</u>	<u>0</u>

Harbor Island Utilities, Inc.

Docket No. 2007-243-W/S

Computation of Depreciation and Amortization
For the Test Year Ended October 31, 2006

Date Acquired	Description	Cost Basis \$	Service Life years	Depr. Rate %	Depr. Expense \$	Accum. Depreciation \$
Fixed Assets Per Revised Application:						
	<u>Pump Equipment</u>					
06/01/86	Water System - upgrade	7,706	17	5.88%	FD	7,706
09/12/00	Water System - upgrade	6,768	15	6.67%	451	3,157
04/30/01	Water System - upgrade	12,883	17	5.88%	758	4,548
08/19/04	Fence around pump	2,906	7	14.29%	415	1,245
01/23/06	Pete Duty & Associates	1,150	7	14.29%	164	164
	<u>Water Mains</u>					
07/01/86	Bridge Crossing	6,863	40	2.50%	172	3,612
08/01/86	Phase I Water Line	1,220	40	2.50%	31	651
11/27/89	Beach Walk Phase I	10,620	40	2.50%	266	4,788
	<u>Services</u>					
11/27/89	Beach Walk Phase I	10,286	40	2.50%	257	4,626
05/16/93	Kelp & Teal Court Connections	330	40	2.50%	8	112
	<u>Hydrants</u>					
07/01/86	Fire Hydrants	7,600	40	2.50%	190	3,990
11/27/89	Beach Walk Phase I	2,569	40	2.50%	64	1,152
08/03/00	Hydrants	1,300	20	5.00%	65	455
02/10/00	Hydrants	2,100	20	5.00%	105	735
	<u>Support Equipment</u>					
06/01/86	Centrifical Pump	1,197	3	33.33%	FD	1,197
01/12/95	Flushquip Retrival Sys. Model T-1	1,570	3	33.33%	FD	1,570
01/12/95	Gastech Gas Monitor GT402	2,972	5	20.00%	FD	2,972
04/17/95	Sampler	2,297	5	20.00%	FD	2,297
04/17/95	Flow Meter	3,200	5	20.00%	FD	3,200
04/17/95	Chlorine scales	1,075	5	20.00%	FD	1,075
06/29/00	Tap costs (non-capital contributions)	2,022	15	6.67%	135	945
08/23/05	Equipment	745	5	20.00%	149	298
	<u>SS Pump Equipment</u>					
02/06/95	Pump Stations	20,000	11	9.09%	FD	20,000
08/02/02	Effluent Line	2,623	20	5.00%	131	655
06/24/04	2 4-HP Sewage Pumps	2,000	15	6.67%	133	399
08/19/04	Material	2,118	7	14.29%	303	909
	<u>SS Collection Systems</u>					
02/06/95	Sewer Collection System	9,300	25	4.00%	372	4,464
	<u>Effluent Line Replacement</u>					
02/10/03	Utility Drawings	298	20	5.00%	15	60
01/02/03	Cast Iron Pump	1,492	15	6.67%	100	400
11/01/03	Effluent Line Replacement	780	20	5.00%	39	156
09/28/05	Effluent Line Replacement	84,013	20	5.00%	4,201	8,402
	<u>TP Treatment Units</u>					
02/06/95	Treatment Plant	40,000	25	4.00%	1,600	19,200
04/12/02	Blower	3,102	12	8.33%	258	1,290
04/07/04	Blower	3,134	12	8.33%	261	783
05/01/04	Blower	5,522	12	8.33%	460	1,380
08/19/04	Fencing	2,906	25	4.00%	116	348
10/21/05	WW Treatment Plant Upgrade	1,307	20	5.00%	65	130
09/25/06	WW Treatment Plant Upgrade (Filter)	90,497	20	5.00%	4,525	4,525
09/25/06	WW Treatment Plant Upgrade (Filter)	1,904	20	5.00%	95	95

Harbor Island Utilities, Inc.
Docket No. 2007-243-W/S
Computation of Depreciation and Amortization
For the Test Year Ended October 31, 2006

Date Acquired	Description	Cost Basis	Service Life	Depr. Rate	Depr. Expense	Accum. Depreciation
		\$	years	%	\$	\$
10/01/06	Treatment Units - Other (Labor for Filter) <u>Sewer Tap Costs</u>	16,922	15	6.67%	1,129	1,129
10/31/06	Sewer Taps - 2006	3,680	15	6.67%	245	245

Total Depreciation Expense Per Revised Application
(using useful lives per Settlement)

17,278

Additional Fixed Assets Capitalized/Removed per Settlement:

07/05/06	BioCharge, etc. - United Labs. (FL#389)	689	5	20.00%	138	138
07/20/06	1720 C Turbidimeter (FL#394)	1,000	5	20.00%	200	200
09/25/06	WW Treatment Plant Upgrade (Filter)	(1,904)	20	5.00%	(95)	(95)
10/31/06	Water Taps - 2006	1,152	15	6.67%	77	77

Net Depreciation Expense

17,598

Contributions in Aid of Construction (CIAC) Per Revised Application:

	<u>Contributed Mains & Services</u>					
05/18/93	Kelp & Teal Court Connection	730	40	2.50%	18	252
03/14/96	Ocean Marsh Sewer Ext.	16,311	40	2.50%	408	4,488
	<u>Contributed-Meters</u>					
10/31/87	Water Tap Costs 1987 (FL#334)	504	15	6.67%	FD	504
10/31/88	Water Tap Costs 1988	204	15	6.67%	FD	204
10/31/89	Water Tap Costs 1989	183	15	6.67%	FD	183
10/31/90	Water Tap Costs 1990	140	15	6.67%	FD	140
02/28/91	Water Tap Costs 1991	478	15	6.67%	FD	478
10/31/92	Water Tap Costs 1992	729	15	6.67%	43	729
10/31/93	Water Tap Costs 1993	1,436	15	6.67%	96	1,344
10/31/94	Water Tap Costs 1994	1,893	15	6.67%	126	1,638
10/31/95	Water Tap Costs 1995	1,273	15	6.67%	85	1,020
10/31/96	Water Tap Costs 1996	1,947	15	6.67%	130	1,430
10/31/97	Water Tap Costs 1997	3,100	15	6.67%	207	2,070
10/31/98	Water Tap Costs 1998	2,502	15	6.67%	167	1,503
10/31/99	Water Tap Costs 1999	1,817	15	6.67%	121	968
04/30/01	Water Tap Costs 2000	6,148	15	6.67%	410	2,460
01/01/05	Water Tap Costs 2004	2,420	15	6.67%	161	322
	<u>Contributed Systems</u>					
05/14/93	Kelp & Teal Court - water mains	4,597	40	2.50%	115	1,610
05/14/93	Kelp & Teal Court - water services	3,819	18	5.56%	212	2,968
09/09/93	Sea Cottages mains & connections	8,968	40	2.50%	224	3,136
09/09/93	Sea Cottages fire hydrants	900	40	2.50%	23	322
09/09/93	Sea Cottages services	4,245	18	5.56%	236	3,304
	<u>Contributed Sewer Taps</u>					
10/31/95	Sewer Tap Costs 1995	20	15	6.67%	1	12
10/31/96	Sewer Tap Costs 1996	260	15	6.67%	17	187
10/31/97	Sewer Tap Costs 1997	380	15	6.67%	25	250
10/31/99	Sewer Tap Costs 1999	5,107	15	6.67%	341	2,728
01/01/05	Sewer Tap Costs 2004	2,420	15	6.67%	161	322

Harbor Island Utilities, Inc.
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Computation of Depreciation and Amortization
For the Test Year Ended October 31, 2006

SETTLEMENT AUDIT EXHIBIT CLS-3
Page 3 of 3

Date Acquired	Description	Cost Basis \$	Service Life years	Depr. Rate %	Depr. Expense \$	Accum. Depreciation \$
	<u>1996 Forward Systems</u>					
11/01/96	Harbor Key (Westmarsh.)	38,394	40	2.50%	960	10,560
11/01/96	Harbor Key (Westmarsh.)	8,775	40	2.50%	219	2,409
11/01/96	Harbor Key (Westmarsh.)	35,930	5	20.00%	FD	35,930
11/01/96	Harbor Key (Westmarsh.)	68,502	25	4.00%	2,740	30,140
11/01/96	Harbor Key (Westmarsh.)	5,855	15	6.67%	391	4,301
07/29/97	Ocean Marsh Sewer Ext.	65,589	40	2.50%	1,640	16,400
Total CIAC Amortization Per Revised Application (using useful lives per Settlement)					<u>9,277</u>	
Additional CIAC Amortized per Settlement:						
10/31/06	Sewer Tap Costs 2006	4,500	15	6.67%	300	300
10/31/06	Water Tap Costs 2006	1,152	15	6.67%	77	77
Total CIAC Amortization					<u>9,654</u>	
Net Depreciation Expense (Page 2 of 3)					17,598	
Less: Total CIAC Amortization					(9,654)	
Total Depreciation Expense for Test Year					<u>7,944</u>	
Less: Per Revised Application Depreciation Expense					(15,212)	
Depreciation and Amortization Adjustment					<u>(7,268)</u>	

FD = Fully Depreciated

SETTLEMENT AUDIT EXHIBIT CLS-4

Harbor Island Utilities, Inc.
Docket No. 2007-243-W/S
Computation of Income Taxes
For the Test Year Ended October 31, 2006

	After Proposed Increase Per Settlement
Total Operating Revenues	\$ 417,336
Less: Operating Expenses	(349,771)
Less: Interest Expense	(13,597)
State Taxable Income	53,968
Less: State Income Taxes @ 5%	(2,698)
Federal Taxable Income	51,270
Federal Income Taxes:	
1st \$50,000 @ 15%	7,500
Remaining Balance @ 25%	318
Total Federal Income Taxes	7,818
Total State and Federal Income Taxes	10,516
Less: Income Taxes after Proposed Accounting and Pro forma Adjustments per Settlement	0
Income Taxes (State and Federal) Adjustment	\$ 10,516